Continued Reforms Improve Investment Climate in Laos

Economic growth in Laos has shown an impressive record - averaging more than 6% per year - since the Government of Laos adopted the New Economic Mechanism in 1986 that opened its door to private participation. The country witnessed rising foreign direct investment (FDI) as well as domestic investment. In 2007, actual FDI inflows were estimated at about US$950 million, a 60 percent increase from 2006. According to a 2006-2007 national business survey by the National Statistic Center, there are about 126,900 local private business units in Laos, comprised mostly of small and medium enterprises (SMEs) and household or family-run activities.

Doing Business in Laos

One of the constraints often mentioned regarding doing business in Laos is the legal and regulatory environment. The World Bank and International Finance Corporation’s (IFC) Doing Business 2008 report finds that although the monetary cost of starting a business in Laos is lower than in many countries in the region, the number of regulatory procedures and days required to start up business operations in the country are high. According to the Investment Climate Assessment of the Asian Development Bank and the World Bank, regulatory policy uncertainty ranks second only to infrastructure as a constraint for manufacturers surveyed with taxation ranking as the third major constraint. Despite this restrictive regulatory regime, firms in Laos do not report spending excessive amounts of time dealing with government regulatory requirements - less in fact than neighbors such as China, Vietnam and Cambodia. However, the number of inspections reported by the private sector is greater than neighboring countries other than China.

The Government is working on improving the business environment by issuing several major laws and decrees for this purpose and receiving policy advice through the PRSO Series. (See Box 1) One of the most important laws is the Enterprise Law, promulgated in 2006 - an important measure for simplifying business start-up procedures. A recent Prime Minister’s Decree of April 2008 implementing the Enterprise Law provides a clear approach for registering firms by clarifying that all businesses are able to register directly with the Ministry of Industry and Commerce without any prior approval from relevant line ministries other than some selected business activities outlined in the decree.

The Enterprise Law abolished the minimum capital requirement for most business sectors and radically changed the Government’s approach to business registration from a process of businesses seeking Government approval to establish themselves to that of simply notifying the Government of business start up as is the case in market economies around the world.

To ensure effective harmonization of laws with the Enterprise Law, the Government is currently preparing a new Investment Law which will streamline foreign investment procedures, rationalize the current investment incentive regime and ensure a level playing field for foreign and domestic investors. This new law will combine the domestic and foreign investment laws and provide a clear investment promotion framework for Laos by guaranteeing investors’ rights and improving transparency and certainty for investors.

Box 1. What is PRSO?
Launched in 2005, the PRSO Series (Poverty Reduction Support Operation) is Government-led program supported by the World Bank, Japan, the European Commission and Australia to implement reform efforts as articulated in the Six National Socio-Economic Development Plan (NSEDPC). Thus far, development partners have provided over 50 million USD for PRSO program in the form of budget support.

PRSO4-7 focuses on two policy areas: (1) sustaining growth through improvement of the investment climate, facilitating trade and management of natural resources; and (2) improving social outcomes through improving public financial management system and service delivery.
Access to Finance

Access to finance is cited in the Investment Climate Assessment as a significant constraint for companies to run a business in Laos. Businesses of all sizes, locations, and industries have been relying heavily on internal funds to finance their operations and investment. Responding to this issue, the government promulgated the Law on Commercial Banks in 2007, which has been a major step for encouraging new commercial banks to establish themselves in Laos. The Law - drafted with the assistance of IFC - offers equal conditions for locally owned, state-owned and foreign owned banks regarding minimum capital requirements and branch network establishment. Since the new law was passed several new banks have been established, most notably Phongsavanh Bank, ANZ Vientiane Commercial Bank and ACLEDA Bank Lao. More banks will mean greater competition, improved access to financing for businesses and also an improvement in services to the public. (IFC Business Issues Bulletin, July 2007).

Despite this progress, several issues continue to limit access to finance. Since lending decisions are so dependant on the availability of collateral and banks generally accept only pledges of immovable assets such as land and buildings, lending continues to be limited. The situation concerning land titles in Laos combined with the limited availability of immovable property for many businesses, especially small and medium enterprises (SMEs), reduces access to financing in Laos. This affects the majority of businesses in Laos where over 90% of the enterprises are SMEs.

To solve this dilemma, the Government is preparing a Decree on Secured Transactions to promote lending based on movable and intangible property such as motor vehicles, machinery, accounts receivable, and inventory. These regulations should make it easier for banks to lend against pledges of movable and intangible property by establishing rules for the establishment of a collateral registration system and guidelines for repossession in the case of default.

Access to markets

As a landlocked country, customs and trade regulations are critical issues in cross-border transactions. The Diagnostic Trade Integration Study shows that the length of customs clearance procedures and cargo processing for imports and exports, and inefficient licensing systems pose barriers to trade in Laos. According to Doing Business 2008, the cost of export and import to Laos are considerably higher and the documentation requirements more burdensome than neighboring countries.

Efforts are underway to improve facilitation of cross-border trade between Laos and other countries in the region through the Greater Mekong Subregion (GMS) Transportation Sector Strategy and other initiatives. The Government has taken important measures to reduce trade facilitation costs and enhance international competitiveness. Key measures that will be implemented in the medium term include the implementation of a new Customs Law, development of a National Trade Facilitation Plan, automation of customs clearance and establishment of a single window for customs clearance. This single window will simultaneously process data and information and combine decision making for customs release and clearance. Later it will be integrated into the ASEAN single window.

The World Bank recently initiated a Customs and Trade Facilitation Project aimed to facilitate trade by improving the efficiency and effectiveness of customs administration. The project will simplify customs procedures, reduce transaction costs and the time to clear goods, and increase transparency and accountability. One of the main features of this project is the implementation of the Automated Systems for Customs Data Management (ASYCUDA). The implementation of ASYCUDA will complement the Government’s decision to centralize customs functions and the reduction of Ministry/Agency functions at border points to no more than three. This activity will also help Laos to meet the actual and future requirement of membership of the WTO.

The soon to be launched Trade Development Facility will support the Government in implementing a trade portal - a website (Lao-Trade.gov.la) where companies can find information on trade from all ministries and obtain licenses and permits online. This project will facilitate international trade and improve food safety and animal and plant health to meet the requirements of WTO accession, AFTA and other international agreements. Complying with Sanitary and Phytosanitary Standards (SPS) is crucial for opening markets to Lao agribusiness exports, especially when public and market requirements for quality and safety are increasing.

Way forward

There are still many issues in need of attention to improve the investment climate in Laos - such as improved infrastructure, especially electricity transmission lines, transport and telecommunications; and increased training to develop a workforce needed to support economic expansion. However the trend toward an improved investment climate resulting from the Government’s continued reform efforts is helping to create a more conducive environment for the private sector and attract more investment. In so doing there is great potential for creating more jobs which can contribute to national prosperity and the Government’s NESDP goal of achieving a 7% annual GDP growth rate, as well as graduating from least developed country (LDC) status by 2020.

To read the Investment Climate Assessment, Lao Economic Monitor, the Diagnostic Trade Integration Study and Doing Business 2008 visit: http://www.worldbank.org/lao

Box 2. The World Bank Group Supports Investment in Laos

- 6 million USD IDA (International Development Association) Financed Customs and Trade Facilitation Project.
- A Multi-donor Trade Development Facility supported by the European Commission, Australia and the World Bank will provide Technical Assistance to support the implementation of Trade Reform.
- Technical assistance provided by IFC to strengthen the business enabling environment, including the drafting of Enterprise Law, Investment Law and Law on Commercial Banks as well as the Decree on Secured Transactions.
- Supporting public-private dialogue through the Lao Business Forum supported by IFC in collaboration with Ministry of Planning and Investment and the Lao National of Chamber of Commerce and Industry.
- Ongoing policy advice through the Poverty Reduction Support Operation series.
- Support for private sector partnership in hydro, mining, agribusiness and infrastructure sectors.

WORLD BANK EVENTS

July 16: World Bank Consultation on Climate Change
July 25: Signing of four grant agreements:
  ♦ Poverty Reduction Support Operation 4
  ♦ Customs and Trade Facilitation Project
  ♦ Khammouane Development Project
  ♦ Poverty Reduction Fund
August 1: Proposed Nam Npum 5 Technical Workshop with Stakeholders
August 8: Launching of Multi Donor Trade Development Facility (Ministry of Finance, Ministry of Industry and Commerce, Ministry of Agriculture and Forestry, World Bank, Australia and the European Commission)
What are the main issues and challenges facing the private sector in Laos?

There are some issues facing the private sector in Laos such as the time consuming process of obtaining licenses. Laos is facing stiff competition from China and India in attracting foreign direct investment (FDI). Thus, improvements in investment policy, the granting of investment incentives and investment strategy are required to attract FDI to Laos.

What efforts have been made to improve the business environment in Laos?

Some improvements have been achieved such as the establishment of a One Stop Service at the Ministry of Planning and Investment to reduce the length of time to issue investment licenses. Regulations on granting investment incentives have also been improved. The Investment Law is now being revised with the involvement of private sector, businesses, embassies, international organizations and academia. Furthermore, the Government has set up priority sectors to attract FDI such as: agro-processing, construction materials, tourism, energy and mining.

What is the government policy for promoting increased foreign investment in Laos?

The Government of Laos welcomes foreign and domestic investment in all sectors. To support this decision, the Investment Promotion Website (http://www.invest.laopdr.org/) is continuously updated with new information and recent laws. Additional funds have been proposed to carry out investment promotion activities and provide more information to investors. The Ministry continues working on an online investment licensing approval system to allow companies to apply through the website.

We disseminate information and train provincial officials regarding investment regulations in order to ensure consistency of implementation throughout the country. We also continue implementing Articles 52 and 53 of the Decree of Prime Minister No. 301/PM on the implementation of the law on the promotion of foreign investment. The law outlines the division of rights and duties of the Committee for the Promotion and Management of Investment related to investment approval, import of materials, equipment and machinery to serve the production of foreign enterprises.

What are the key contributions of the Lao Business Forum to improving the business environment?

The Lao Business Forum provides an opportunity to the private sector to share their views and opinions on the legal and regulatory environment and facilitates discussion between the public and private sector. This dialogue will help clarify some investment issues and build trust between the private sector and government.
World Bank Update on Nam Theun 2 Project Activities

Resettlers Move into their New Homes While New Income Generating Activities Arise

The relocation of 6,200 people in the Nakai Plateau is now complete. People are living in their new and improved households, with safe and reliable water supply, roads and electricity. This, according to the forthcoming annual progress report from the World Bank and Asian Development Bank (ADB) on the Nam Theun 2 (NT2) hydroelectric project. NT2 is the largest public-private partnership in Laos.

The reservoir is starting to form, following tunnel diversion closure in April and dam gate closure now imminent. The Nakai resettlers are working closely with the Nam Theun 2 Power Company (NTPC) and the Lao Government (GOL) to ensure they can maximize their new living opportunities and double their income in five years time as stipulated in the project’s Concession Agreement.

“The main aim of this project is to harness a natural resource that can bring great revenues to this country and help it eradicate poverty, while improving the environment and the lives of the people impacted by the project,” said Patchamuthu Illangovan, World Bank Country Manager in Laos.

As the annual update reports, livelihood development programs for the Nakai resettlers focus on agriculture, livestock raising, off-farm activities, forestry and fishing in the reservoir. Previously allocated plots of land to households are being cleared by villagers for agriculture activities. Meanwhile a GOL decree gives the resettlers exclusive rights to fish in the reservoir. Previously hunter-gatherers, the Nakai villagers now work on a daily basis with NTPC and Lao Government staff as they embrace the new programs with a greater focus on a market economy. Villagers are learning the required ‘know-how’ including how to increase efficiency in rice production, planting new crops, accessing new markets for products and fishing in the reservoir, among others.

Meanwhile in the areas around Gnommalath District, where villagers have lost land due to project construction, compensation payments have been completed either in cash or land. Around Khemkeut District, downstream of the Nam Theun river, villagers potentially impacted by the decreased flow of the river are being closely monitored to ensure prospective cases of protein deficiency are resolved. At the same time, these villagers are working on livelihood programs based on fish ponds and alternative crops, among others, that will help them maintain their living standards.

The people living downstream along the Xe Bang Fai river are also taking part in livelihood programs developed through village revolving funds. These funds are now targeting 48 villages and will be scaled up to others in the future, based on timing of impacts. The aim is to give communities a resource where they can draw money from to invest in activities ranging from a small business, to fish ponds, to livestock, so that they can prepare for potential impacts on fish that will result once the dam starts operating in December 2009. In addition, water and sanitation infrastructure is being provided by the project to increase village health. The project’s approach has been to develop the programs ahead of time, so villagers can more easily transition and thereby maintain their living standards.

On environmental aspects, the forthcoming World Bank/ADB report notes that 86 percent of the 80 kilometer square area of the reservoir that will be permanently filled with water has been cleared of vegetation. This clearance will allow for improved navigation in the reservoir, while also contributing to improving water quality. Newly formed reservoirs usually experience poor water quality in the beginning. The project also has in place additional measures to manage water quality including increasing aeration, adjusting the intake structure design and flushing water out of the dam after the initial filling. These are four globally recognized strategies for managing water quality in reservoirs.

Work in protection and conservation in the 4,000 kilometer square Nakai-Nam Theun Protected Area, the largest protected area in mainland Southeast Asia, also continues to make progress. This includes halting illegal logging and wildlife poaching. Work is also being undertaken with villagers living in the area to enhance their livelihoods while protecting their environment.

Once Nam Theun 2 starts generating electricity in December 2009, 95 percent of the energy will be sold to Thailand. Revenues for the Lao Government will be US$34 million annually for the first ten years as financing debts are repaid. The Lao government is committed to employing these funds for pro-poor programs.

The Lao Government’s public financial management program, supported by the World Bank, is working to enhance the efficiency and transparency in managing funds, including through an enhanced budget law which was enacted in 2007. The Lao Government has made notable progress on these reform efforts since the programs began to be implemented in 2005. The Government is also working on choosing the priority programs where the money will be destined.

The report notes that a high level of project monitoring continues, with independent experts, monitoring agencies, financing institutions, academics, media and others continuously visiting the project and reporting and advising on its progress. The development of NT2 is already providing important lessons for investors and for public-private partnerships in Laos.

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